

rules that the taxes are allocated on an annual basis and that foreign taxes paid on U.S. source income shall be allocated to the separate category that includes that U.S. source income (see §1.904-6(a)), shall apply for purposes of allocating taxes to separate categories. Allocation of taxes pursuant to §1.904-6 shall be made before the recapture of any separate limitation loss accounts of the taxpayer pursuant to the rules of this section.

(c) *Effective/applicability date.* This section applies to taxpayers that sustain separate limitation losses in taxable years beginning on or after January 1, 2012. Taxpayers may choose to apply this section to separate limitation losses sustained in other taxable years beginning after December 21, 2007, including periods covered by 26 CFR §1.904(f)-8T (revised as of April 1, 2010). For rules relating to taxable years beginning after December 31, 1986, and on or before December 21, 2007, see section 904(f)(5).

[T.D. 9595, 77 FR 37580, June 22, 2012]

§§ 1.904(f)-9—1.904(f)-11 [Reserved]

§ 1.904(f)-12 Transition rules.

(a) *Recapture in years beginning after December 31, 1986, of overall foreign losses incurred in taxable years beginning before January 1, 1987—(1) In general.* If a taxpayer has a balance in an overall foreign loss account at the end of its last taxable year beginning before January 1, 1987 (pre-effective date years), the amount of that balance shall be recaptured in subsequent years by re-characterizing income received in the income category described in section 904(d) as in effect for taxable years beginning after December 31, 1986 (post-effective date years), that is analogous to the income category for which the overall foreign loss account was established, as follows:

(i) Interest income as defined in section 904(d)(1)(A) as in effect for pre-effective date taxable years is analogous to passive income as defined in section

904(d)(1)(A) as in effect for post-effective date years;

(ii) Dividends from a DISC or former DISC as defined in section 904(d)(1)(B) as in effect for pre-effective date taxable years is analogous to dividends from a DISC or former DISC as defined in section 904(d)(1)(F) as in effect for post-effective date taxable years;

(iii) Taxable income attributable to foreign trade income as defined in section 904(d)(1)(C) as in effect for pre-effective date taxable years is analogous to taxable income attributable to foreign trade income as defined in section 904(d)(1)(G) as in effect for post-effective date years;

(iv) Distributions from a FSC (or former FSC) as defined in section 904(d)(1)(D) as in effect for pre-effective date taxable years is analogous to distributions from a FSC (or former FSC) as defined in section 904(d)(1)(H) as in effect for post-effective date taxable years;

(v) For general limitation income as described in section 904(d)(1)(E) as in effect for pre-effective date taxable years, see the special rule in paragraph (a)(2) of this section.

(2) *Rule for general limitation losses—(i) In general.* Overall foreign losses incurred in the general limitation category of section 904(d)(1)(E), as in effect for pre-effective date taxable years, that are recaptured in post-effective date taxable years shall be recaptured from the taxpayer's general limitation income, financial services income, shipping income, and dividends from each noncontrolled section 902 corporation. If the sum of the taxpayer's general limitation income, financial services income, shipping income and dividends from each noncontrolled section 902 corporation for a taxable year subject to recapture exceeds the overall foreign loss to be recaptured, then the amount of each type of separate limitation income that will be treated as U.S. source income shall be determined as follows:

$$\text{Overall foreign loss subject to recapture} \times \frac{\text{Amount of income in each separate category from which the loss may be recaptured}}{\text{Sum of income in all separate categories from which the loss may be recaptured.}}$$

This recapture shall be made after the allocation of separate limitation losses pursuant to section 904(f)(5)(B) and before the recharacterization of post-effective date separate limitation income pursuant to section 904(f)(5)(C).

(ii) *Exception.* If a taxpayer can demonstrate to the satisfaction of the district director that an overall foreign loss in the general limitation category of section 904(d)(1)(E), as in effect for pre-effective date taxable years, is attributable, in sums certain, to losses in one or more separate categories of section 904(d)(1) (including for this purpose the passive income category and the high withholding tax interest category), as in effect for post-effective date taxable years, then the taxpayer may recapture the loss (in the amounts demonstrated) from those separate categories only.

(3) *Priority of recapture of overall foreign losses incurred in pre-effective date taxable years.* An overall foreign loss incurred by a taxpayer in pre-effective date taxable years shall be recaptured to the extent thereof before the taxpayer recaptures an overall foreign loss incurred in a post-effective date taxable year.

(4) *Examples.* The following examples illustrate the application of this paragraph (a).

Example 1. X corporation is a domestic corporation which operates a branch in Country Y. For its taxable year ending December 31, 1988, X has \$800 of financial services income, \$100 of general limitation income and \$100 of shipping income. X has a balance of \$100 in its general limitation overall foreign loss account which resulted from an overall foreign loss incurred during its 1986 taxable year. X is unable to demonstrate to which of the income categories set forth in section 904(d)(1) as in effect for post-effective date taxable years the loss is attributable. In addition, X has a balance of \$100 in its shipping overall foreign loss account attributable to a shipping loss incurred during its 1987 taxable year. X has no other overall foreign loss accounts. Pursuant to section 904(f)(1), the full amount in each of X corporation's overall

foreign loss accounts is subject to recapture since \$200 (the sum of those amounts) is less than 50% of X's foreign source taxable income for its 1988 taxable year, or \$500. X's overall foreign loss incurred during its 1986 taxable year is recaptured before the overall foreign loss incurred during its 1987 taxable year, as follows: \$80 ($\$100 \times 800/1000$) of X's financial services income, \$10 ($\$100 \times 100/1000$) of X's general limitation income, and \$10 ($\$100 \times 100/1000$) of X's shipping income will be treated as U.S. source income. The remaining \$90 of X corporation's 1988 shipping income will be treated as U.S. source income for the purpose of recapturing X's 100 overall foreign loss attributable to the shipping loss incurred in 1987. \$10 remains in X's shipping overall foreign loss account for recapture in subsequent taxable years.

Example 2. The facts are the same as in *Example 1* except that X has \$800 of financial services income, \$100 of general limitation income, a \$100 dividend from a noncontrolled section 902 corporation and a (\$100) shipping loss for its taxable year ending December 31, 1988. Separate limitation losses are allocated pursuant to the rules of section 904(f)(5) before the recapture of overall foreign losses. Therefore, the (\$100) shipping loss incurred by X will be allocated to its separate limitation income as follows: \$80 ($\$100 \times 800/1000$) will be allocated to X's financial services income, \$10 ($\$100 \times 100/1000$) will be allocated to its general limitation income and \$10 ($\$100 \times 100/1000$) will be allocated to X's dividend from the noncontrolled section 902 corporation. Accordingly, after allocation of the 1988 shipping loss, X has \$720 of financial services income, \$90 of general limitation income, and a \$90 dividend from the noncontrolled section 902 corporation. Pursuant to section 904(f)(1), the full amount in each of X corporation's overall foreign loss accounts is subject to recapture since \$200 (the sum of those amounts) is less than 50% of X's net foreign source taxable income for its 1988 taxable year, or \$450. X's overall foreign loss incurred during its 1986 taxable year is recaptured as follows: \$80 ($\$100 \times 720/900$) of X's financial services income, \$10 ($\$100 \times 90/900$) of its general limitation income and \$10 ($\$100 \times 90/900$) of its dividend from the noncontrolled section 902 corporation will be treated as U.S. source income. Accordingly, after application of section 904(f), X has \$100 of U.S. source income, \$640 of financial services income, \$80 of general limitation income and a \$80 dividend from the noncontrolled section

902 corporation for its 1988 taxable year. X must establish a separate limitation loss account for each portion of the 1988 shipping loss that was allocated to its financial services income, general limitation income and dividends from the noncontrolled section 902 corporation. X's overall foreign loss account for the 1986 general limitation loss is reduced to zero. X still has a \$100 balance in its overall foreign loss account that resulted from the 1987 shipping loss.

Example 3. Y is a domestic corporation which has a branch operation in Country Z. For its 1988 taxable year, Y has \$5 of shipping income, \$15 of general limitation income and \$100 of financial services income. Y has a balance of \$100 in its general limitation overall foreign loss account attributable to its 1986 taxable year. Y has no other overall foreign loss accounts. Pursuant to section 904(f)(1), \$60 of the overall foreign loss is subject to recapture since 50% of Y's foreign source income for 1988 is less than the balance in its overall foreign loss account. Y can demonstrate that the entire \$100 overall foreign loss was attributable to a shipping limitation loss incurred in 1986. Accordingly, only Y's \$5 of shipping limitation income received in 1988 will be treated as U.S. source income. Because Y can demonstrate that the 1986 loss was entirely attributable to a shipping loss, none of Y's general limitation income or financial services income received in 1988 will be treated as U.S. source income.

Example 4. The facts are the same as in *Example 3* except that Y can only demonstrate that \$50 of the 1986 overall foreign loss account was attributable to a shipping loss incurred in 1986. Accordingly, Y's \$5 of shipping limitation income received in 1988 will be treated as U.S. source income. The remaining \$50 of the 1986 overall foreign loss that Y cannot trace to a particular separate limitation will be recaptured and treated as U.S. source income as follows: \$43 ($\$50 \times 100/115$) of Y's financial services income will be treated as U.S. source income and \$7 ($\$50 \times 15/115$) of Y's general limitation income will be treated as U.S. source income. Y has \$45 remaining in its overall foreign loss account to be recaptured from shipping income in a future year.

(b) *Treatment of overall foreign losses that are part of net operating losses incurred in pre-effective date taxable years which are carried forward to post-effective date taxable years—(1) Rule.* An overall foreign loss that is part of a net operating loss incurred in a pre-effective date taxable year which is carried forward, pursuant to section 172, to a post-effective date taxable year will be carried forward under the rules of section 904(f)(5) and the regulations under that section. *See also* Notice 89-3, 1989-

1 C.B. 623. For this purpose the loss must be allocated to income in the category analogous to the income category set forth in section 904(d) as in effect for pre-effective date taxable years in which the loss occurred. The analogous category shall be determined under the rules of paragraph (a) of this section.

(2) *Example.* The following example illustrates the rule of paragraph (b)(1) of this section.

Example. Z is a domestic corporation which has a branch operation in Country D. For its taxable year ending December 31, 1988, Z has \$100 of passive income and \$200 of general limitation income. Z also has a \$60 net operating loss which was carried forward pursuant to section 172 from its 1986 taxable year. The net operating loss resulted from an overall foreign loss attributable to the general limitation income category. Z can demonstrate that the loss is a shipping loss. Therefore, the net operating loss will be treated as a shipping loss for Z's 1988 taxable year. Pursuant to section 904(f)(5), the shipping loss will be allocated as follows: \$20 ($\$60 \times 100/300$) will be allocated to Z's passive income and \$40 ($\$60 \times 200/300$) will be allocated to Z's general limitation income. Accordingly, after application of section 904(f), Z has \$80 of passive income and \$160 of general limitation income for its 1988 taxable year. Although no addition to Z's overall foreign loss account for shipping income will result from the NOL carry forward, shipping income earned by Z in subsequent taxable years, will be subject to recharacterization as a passive income and general limitation income pursuant to the rules set forth in section 904(f)(5).

(c) *Treatment of overall foreign losses that are part of net operating losses incurred in post-effective date taxable years which are carried back to pre-effective date taxable years—(1) Allocation to analogous income category.* An overall foreign loss that is part of a net operating loss incurred by the taxpayer in a post-effective date taxable year which is carried back, pursuant to section 172, to a pre-effective date taxable year shall be allocated first to income in the pre-effective date income category analogous to the income category set forth in section 904(d) as in effect for post-effective date taxable years in which the loss occurred. Except for the general limitation income category, the pre-effective date income category that is analogous to a post-effective

date income category shall be determined under paragraphs (a)(1) (i) through (iv) of this section. The general limitation income category for pre-effective date years shall be treated as the income category that is analogous to the post-effective date categories for general limitation income, financial services income, shipping income, dividends from each noncontrolled section 902 corporation and high

withholding tax interest income. If the net operating loss resulted from separate limitation losses in more than one post-effective date income category and more than one loss is carried back to pre-effective date general limitation income, then the losses shall be allocated to the pre-effective date general limitation income based on the following formula:

$$\text{Pre-effective date general limitation income} \times \frac{\text{Loss in each post-effective date separate limitation category that is analogous to pre-effective date general limitation income}}{\text{Losses in all post-effective categories that are analogous to pre-effective date general limitation income}}$$

(2) *Allocation to U.S. source income.* If an overall foreign loss is carried back to a pre-effective date taxable year and the loss exceeds the foreign source income in the analogous category for the carry back year, the remaining loss shall be allocated against U.S. source income as set forth in § 1.904(f)-3. The amount of the loss that offsets U.S. source income must be added to the taxpayer's overall foreign loss account. An addition to an overall foreign loss account resulting from the carry back of a net operating loss incurred by a taxpayer in a post-effective date taxable year shall be treated as having been incurred by the taxpayer in the year in which the loss arose and shall be subject to recapture pursuant to section 904(f) as in effect for post-effective date taxable years.

(3) *Allocation to other separate limitation categories.* To the extent that an overall foreign loss that is carried back as part of a net operating loss exceeds the separate limitation income to which it is allocated and the U.S. source income of the taxpayer for the taxable year to which the loss is carried, the loss shall be allocated pro rata to other separate limitation income of the taxpayer for the taxable year. However, there shall be no recharacterization of separate limitation income pursuant to section 904(f)(5) as a result of the allocation of such a net

operating loss to other separate limitation income of the taxpayer.

(4) *Examples.* The following examples illustrate the rules of paragraph (c) of this section.

Example 1. X is a domestic corporation which has a branch operation in Country A. For its taxable year ending December 31, 1987, X has a \$60 net operating loss which is carried back pursuant to section 172 to its taxable year ending December 31, 1985. The net operating loss resulted from a shipping loss; X had no U.S. source income in 1987. X had \$20 of general limitation income, \$40 of DISC limitation income and \$10 of U.S. source income for its 1985 taxable year. The \$60 NOL is allocated first to X's 1985 general limitation income to the extent thereof (\$20) since the general limitation income category of section 904(d) as in effect for pre-effective date taxable years is the income category that is analogous to shipping income for post-effective date taxable years. Therefore, X has no general limitation income for its 1985 taxable year. Next, pursuant to section 904(f) as in effect for pre-effective date taxable years, the remaining \$40 of the NOL is allocated first to X's \$10 of U.S. source income and then to \$30 of X's DISC limitation income for its 1985 taxable year. Accordingly, X has no U.S. source income and \$10 of DISC limitation income for its 1985 taxable year after allocation of the NOL. X has a \$10 balance in its shipping overall foreign loss account which is subject to recapture pursuant to section 904(f) as in effect for post-effective date taxable years. X will not be required to recharacterize, pursuant to section 904(f)(5), subsequent shipping income as DISC limitation income.

Example 2. Y is a domestic corporation which has a branch operation in Country B. For its taxable year ending December 31, 1987, X has a \$200 net operating loss which is carried back pursuant to section 172 to its taxable year ending December 31, 1986. The net operating loss resulted from a (\$100) general limitation loss and a (\$100) shipping loss. Y had \$100 of general limitation income and \$200 of U.S. source income for its taxable year ending December 31, 1986. The separate limitation losses for 1987 are allocated pro rata to Y's 1986 general limitation income as follows: \$50 of the (\$100) general limitation loss ($\$100 \times 100/200$) and \$50 of the (\$100) shipping loss ($\$100 \times 100/200$) is allocated to Y's \$100 of 1986 general limitation income. The remaining \$50 of Y's general limitation loss and the remaining \$50 of Y's shipping loss are allocated to Y's 1986 U.S. source income. Accordingly, Y has no foreign source income and \$100 of U.S. source income for its 1986 taxable year. Y has a \$50 balance in its general limitation overall foreign loss account and a \$50 balance in its shipping overall foreign loss account, both of which will be subject to recapture pursuant to section 904(f) as in effect for post-effective date taxable years.

(d) *Recapture of FORI and general limitation overall foreign losses incurred in taxable years beginning before January 1, 1983.* For taxable years beginning after December 31, 1986, and before January 1, 1991, the rules set forth in § 1.904 (f)-6 shall apply for purposes of recapturing general limitation and foreign oil related income (FORI) overall foreign losses incurred in taxable years beginning before January 1, 1983 (pre-1983). For taxable years beginning after December 31, 1990, the rules set forth in this section shall apply for purposes of recapturing pre-1983 general limitation and FORI overall foreign losses.

(e) *Recapture of pre-1983 overall foreign losses determined on a combined basis.* The rules set forth in paragraph (a)(2) of this section shall apply for purposes of recapturing overall foreign losses incurred in taxable years beginning before January 1, 1983, that were computed on a combined basis in accordance with § 1.904 (f)-1(c) (1).

(f) *Transition rules for taxable years beginning before December 31, 1990.* For transition rules for taxable years beginning before January 1, 1990, see 26 CFR 1.904 (f)-13T as it appeared in the Code of Federal Regulations revised as of April 1, 1990.

(g) *Recapture in years beginning after December 31, 2002, of separate limitation losses and overall foreign losses incurred in years beginning before January 1, 2003, with respect to the separate category for dividends from a noncontrolled section 902 corporation—(1) Recapture of separate limitation loss or overall foreign loss in a separate category for dividends from a noncontrolled section 902 corporation.* To the extent that a taxpayer has a balance in any separate limitation loss or overall foreign loss account in a separate category for dividends from a noncontrolled section 902 corporation under section 904(d)(1)(E) (prior to its repeal by Public Law 108-357, 118 Stat. 1418 (October 22, 2004)) at the end of the taxpayer's last taxable year beginning before January 1, 2003 (or a later taxable year in which the taxpayer received a dividend subject to a separate limitation for dividends from that noncontrolled section 902 corporation), the amount of such balance shall be allocated on the first day of the taxpayer's next taxable year to the taxpayer's other separate categories. The amount of such balance shall be allocated in the same percentages as the taxpayer properly characterized the stock of the noncontrolled section 902 corporation for purposes of apportioning the taxpayer's interest expense for its first taxable year ending after the first day of such corporation's first taxable year beginning after December 31, 2002, under § 1.861-12T(c)(3) or § 1.861-12(c)(4), as the case may be. To the extent a taxpayer has a balance in any separate limitation loss account in a separate category for dividends from a noncontrolled section 902 corporation with respect to another separate category, and the separate limitation loss would otherwise be assigned to that other category under this paragraph (g)(1), such balance shall be eliminated.

(2) *Recapture of separate limitation loss in another separate category.* To the extent that a taxpayer has a balance in any separate limitation loss account in a separate category with respect to a separate category for dividends from a noncontrolled section 902 corporation under section 904(d)(1)(E) (prior to its repeal by Public Law 108-357, 118 Stat. 1418 (October 22, 2004)) at the end of the taxpayer's last taxable year with or

within which ends the last taxable year of the noncontrolled section 902 corporation beginning before January 1, 2003, such loss shall be recaptured in subsequent taxable years as income in the appropriate separate categories. The separate limitation loss shall be recaptured as income in other separate categories in the same percentages as the taxpayer properly characterizes the stock of the noncontrolled section 902 corporation for purposes of apportioning the taxpayer's interest expense in its first taxable year ending after the first day of the foreign corporation's first taxable year beginning after December 31, 2002, under § 1.861-12T(c)(3) or § 1.861-12(c)(4), as the case may be. To the extent a taxpayer has a balance in a separate limitation loss account in a separate category that would have been recaptured as income in that same category under this paragraph (g)(2), such balance shall be eliminated.

(3) *Exception.* Where a taxpayer formerly met the stock ownership requirements of section 902(a) with respect to a foreign corporation, but did not meet the requirements of section 902(a) on December 20, 2002 (or on the first day of the taxpayer's first taxable year beginning after December 31, 2002, in the case of a transaction that was the subject of a binding contract in effect on December 20, 2002), if the taxpayer has a balance in any separate limitation loss or overall foreign loss account for a separate category for dividends from that foreign corporation under section 904(d)(1)(E) (prior to its repeal by Public Law 108-357, 118 Stat. 1418 (October 22, 2004)) at the end of the taxpayer's last taxable year beginning before January 1, 2003, then the amount of such balance shall not be subject to recapture under section 904(f) and this section. If a separate limitation loss or overall foreign loss account for such category is not subject to recapture under this paragraph (g)(3), the taxpayer cannot carry over any unused foreign taxes in such separate category to any other limitation category. However, a taxpayer may elect to recapture the balances of all separate limitation loss and overall foreign loss accounts for all separate categories for dividends from such for-

merly-owned noncontrolled section 902 corporations under the rules of paragraphs (g)(1) and (2) of this section. If a taxpayer so elects, it may carry over any unused foreign taxes in these separate categories to the appropriate separate categories as provided in § 1.904-2(h).

(4) *Examples.* The following examples illustrate the application of this paragraph (g):

Example 1. X is a domestic corporation that meets the ownership requirements of section 902(a) with respect to Y, a foreign corporation the stock of which X owns 50 percent. Therefore, Y is a noncontrolled section 902 corporation with respect to X. Both X and Y use the calendar year as their taxable year. As of December 31, 2002, X had a \$100 balance in its separate limitation loss account for the separate category for dividends from Y, of which \$60 offset general limitation income and \$40 offset passive income. For purposes of apportioning X's interest expense for its 2003 taxable year, X properly characterized the stock of Y as a multiple category asset (80% general and 20% passive). Under paragraph (g)(1) of this section, on January 1, 2003, \$80 ($\$100 \times 80/100$) of the \$100 balance in the separate limitation loss account is assigned to the general limitation category. Of this \$80 balance, \$32 ($\$80 \times 40/100$) is with respect to the passive category, and \$48 ($\$80 \times 60/100$) is with respect to the general limitation category and therefore is eliminated. The remaining \$20 balance ($\$100 \times 20/100$) of the \$100 balance is assigned to the passive category. Of this \$20 balance, \$12 ($\$20 \times 60/100$) is with respect to the general limitation category, and \$8 ($\$20 \times 40/100$) is with respect to the passive category and therefore is eliminated.

Example 2. The facts are the same as in *Example 1*, except that as of December 31, 2002, X had a \$30 balance in its separate limitation loss account in the general limitation category, and a \$20 balance in its separate limitation loss account in the passive category, both of which offset income in the separate category for dividends from Y. Under paragraph (g)(2) of this section, the separate limitation loss accounts in the general limitation and passive categories with respect to the separate category for dividends from Y will be recaptured on and after January 1, 2003, from income in other separate categories, as follows. Of the \$30 balance in X's separate limitation loss account in the general category with respect to the separate category for dividends from Y, \$6 ($\$30 \times 20/100$) is with respect to the passive category, and \$24 ($\$30 \times 80/100$) is with respect to the general limitation category and therefore is eliminated. Of the \$20 balance in X's separate

limitation loss account in the passive category with respect to the separate category for dividends from Y, \$16 ($\$20 \times 80/100$) will be recaptured out of general limitation income, and \$4 ($\$20 \times 20/100$) would otherwise be recaptured out of passive income and therefore is eliminated.

(5) *Effective/applicability date.* This paragraph (g) applies to taxable years ending on or after April 20, 2009. See 26 CFR 1.904(f)-12T(g) (revised as of April 1, 2009) for rules applicable to taxable years beginning after December 31, 2002, and ending before April 20, 2009.

(h) *Recapture in years beginning after December 31, 2006, of separate limitation losses and overall foreign losses incurred in years beginning before January 1, 2007—*(1) *Losses related to pre-2007 separate categories for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC—*(i) *Recapture of separate limitation loss or overall foreign loss incurred in a pre-2007 separate category for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC.* To the extent that a taxpayer has a balance in any separate limitation loss or overall foreign loss account in a pre-2007 separate category (as defined in § 1.904-7(g)(1)(ii)) for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC, at the end of the taxpayer's last taxable year beginning before January 1, 2007, the amount of such balance, or balances, shall be allocated on the first day of the taxpayer's next taxable year to the taxpayer's post-2006 separate category (as defined in § 1.904-7(g)(1)(iii)) for passive category income.

(ii) *Recapture of separate limitation loss with respect to a pre-2007 separate category for passive income, certain dividends from a DISC or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC.* To the extent that a taxpayer has a balance in any separate limitation loss account in any pre-2007 separate category with respect to a pre-2007 separate category for passive income, certain dividends from a DISC

or former DISC, taxable income attributable to certain foreign trade income or certain distributions from a FSC or former FSC at the end of the taxpayer's last taxable year beginning before January 1, 2007, such loss shall be recaptured in subsequent taxable years as income in the post-2006 separate category for passive category income.

(2) *Losses related to pre-2007 separate categories for shipping, financial services income or general limitation income—*(i) *Recapture of separate limitation loss or overall foreign loss incurred in a pre-2007 separate category for shipping income, financial services income or general limitation income.* To the extent that a taxpayer has a balance in any separate limitation loss or overall foreign loss account in a pre-2007 separate category for shipping income, financial services income or general limitation income at the end of the taxpayer's last taxable year beginning before January 1, 2007, the amount of such balance, or balances, shall be allocated on the first day of the taxpayer's next taxable year to the taxpayer's post-2006 separate category for general category income.

(ii) *Recapture of separate limitation loss with respect to a pre-2007 separate category for shipping income, financial services income or general limitation income.* To the extent that a taxpayer has a balance in any separate limitation loss account in any pre-2007 separate category with respect to a pre-2007 separate category for shipping income, financial services income or general limitation income at the end of the taxpayer's last taxable year beginning before January 1, 2007, such loss shall be recaptured in subsequent taxable years as income in the post-2006 separate category for general category income.

(3) *Losses related to a pre-2007 separate category for high withholding tax interest—*(i) *Recapture of separate limitation loss or overall foreign loss incurred in a pre-2007 separate category for high withholding tax interest.* To the extent that a taxpayer has a balance in any separate limitation loss or overall foreign loss account in a pre-2007 separate category for high withholding tax interest at the end of the taxpayer's last taxable year beginning before January 1, 2007, the amount of such balance shall

be allocated on the first day of the taxpayer's next taxable year on a pro rata basis to the taxpayer's post-2006 separate categories for general category and passive category income, based on the proportion in which any unused foreign taxes in the same pre-2007 separate category for high withholding tax interest are allocated under § 1.904-2(i)(1). If the taxpayer, other than a financial services entity as defined in § 1.904-4(e)(3), has no unused foreign taxes in the pre-2007 separate category for high withholding tax interest, then any loss account balance in that category shall be allocated to the post-2006 separate category for passive category income. If the taxpayer is a financial services entity, as defined in § 1.904-4(e)(3), and has no unused foreign taxes in the pre-2007 separate category for high withholding tax interest, then any loss account balance in that category shall be allocated to the post-2006 separate category for general category income.

(ii) *Recapture of separate limitation loss with respect to a pre-2007 separate category for high withholding tax interest.* To the extent that a taxpayer has a balance in a separate limitation loss account in any pre-2007 separate category with respect to a pre-2007 separate category for high withholding tax interest at the end of the taxpayer's last taxable year beginning before January 1, 2007, such loss shall be recaptured in subsequent taxable years on a pro rata basis as income in the post-2006 separate categories for general category and passive category income, based on the proportion in which any unused foreign taxes in the pre-2007 separate category for high withholding tax interest are allocated under § 1.904-2(i)(1). If the taxpayer, other than a financial services entity as defined in § 1.904-4(e)(3), has no unused foreign taxes in the pre-2007 separate category for high withholding tax interest, then the loss account balance shall be recaptured in subsequent taxable years solely as income in the post-2006 separate category for passive category income. If the taxpayer is a financial services entity, as defined in § 1.904-4(e)(3), and has no unused foreign taxes in the pre-2007 separate category for high withholding tax interest, then the loss ac-

count balance shall be recaptured in subsequent taxable years solely as income in the post-2006 separate category for general category income.

(4) *Elimination of certain separate limitation loss accounts.* After application of paragraphs (h)(1) through (h)(3) of this section, any separate limitation loss account allocated to the post-2006 separate category for passive category income for which income is to be recaptured as passive category income, as determined under those same provisions, shall be eliminated. Similarly, after application of paragraphs (h)(1) through (h)(3) of this section, any separate limitation loss account allocated to the post-2006 separate category for general category income for which income is to be recaptured as general category income, as determined under those same provisions, shall be eliminated.

(5) *Alternative method.* In lieu of applying the rules of paragraphs (h)(1) through (h)(3) of this section, a taxpayer may apply the principles of paragraphs (g)(1) and (g)(2) of this section to determine recapture in taxable years beginning after December 31, 2006, of separate limitation losses and overall foreign losses incurred in taxable years beginning before January 1, 2007. A taxpayer may choose to use the alternative method on a timely filed (original or amended) tax return or during an audit. A taxpayer that uses the alternative method on an amended return or in the course of an audit must make appropriate adjustments to eliminate any double benefit arising from application of the alternative method to years that are not open for assessment. A taxpayer's choice to use the alternative method is evidenced by employing the method. The taxpayer need not file any separate statement.

(6) *Effective/applicability date.* This paragraph (h) shall apply to taxable years beginning after December 31, 2006, and ending on or after December 31, 2007. However, taxpayers may choose to apply 26 CFR 1.904(f)-12T(h) as it appeared in the Code of Federal Regulations as of April 1, 2010, in lieu of this paragraph (h) to taxable years beginning after December 31, 2006 and ending on or after December 31, 2007, but ending before April 7, 2011 provided

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that appropriate adjustments are made to eliminate duplicate benefits arising from application of 26 CFR 1.904(f)-12T(h) to taxable years that are not open for assessment. In addition, if a taxpayer that is a financial services entity (as defined in § 1.904-4(e)(3)) chooses to apply 26 CFR 1.904(f)-12T(h) to taxable years ending before April 7, 2011, then as of the beginning of the taxpayer's first taxable year ending on or after April 7, 2011 any remaining balance in a passive category loss account that is attributable to a loss account in a pre-2007 separate category for high withholding tax interest shall be allocated to the general category or eliminated pursuant to § 1.904(f)-12(h)(4), and any remaining balance in a separate limitation loss account with respect to passive category income that is attributable to a loss account with respect to a pre-2007 separate category for high withholding tax interest will be recaptured in such year and subsequent taxable years as general category income or eliminated pursuant to § 1.904(f)-12(h)(4).

[T.D. 8306, 55 FR 31381, Aug. 2, 1990, as amended by T.D. 9260, 71 FR 24539, Apr. 25, 2006; T.D. 9368, 72 FR 72591, Dec. 21, 2007; T.D. 9452, 74 FR 27886, June 11, 2009; T.D. 9521, 76 FR 19273, Apr. 7, 2011]

§ 1.904(g)-0 Outline of regulation provisions.

This section lists the headings for §§ 1.904(g)-1 through 1.904(g)-3.

§ 1.904(g)-1 Overall domestic loss and the overall domestic loss account.

- (a) Overview of regulations.
- (b) Overall domestic loss accounts.
 - (1) In general.
 - (2) Taxable year in which overall domestic loss is sustained.
- (c) Determination of a taxpayer's overall domestic loss.
 - (1) Overall domestic loss defined.
 - (2) Domestic loss defined.
 - (3) Qualified taxable year defined.
 - (4) Method of allocation and apportionment of deductions.
- (d) Additions to overall domestic loss accounts.
 - (1) General rule.
 - (2) Overall domestic loss of another taxpayer.
 - (3) Adjustments for capital gains and losses.
- (e) Reductions of overall domestic loss accounts.

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- (1) Pre-recapture reduction for amounts allocated to other taxpayers.
- (2) Reduction for amounts recaptured.
- (f) Effective/applicability date.

§ 1.904(g)-2 Recapture of overall domestic losses.

- (a) In general.
- (b) Determination of U.S. source taxable income for purposes of recapture.
- (c) Section 904(g)(1) recapture.
- (d) Effective/applicability date.

§ 1.904(g)-3 Ordering rules for the allocation of net operating losses, net capital losses, U.S. source losses, and separate limitation losses, and for recapture of separate limitation losses, overall foreign losses, and overall domestic losses.

- (a) In general.
- (b) Step One: Allocation of net operating loss and net capital loss carryovers.
 - (1) In general.
 - (2) Full net operating loss carryover.
 - (3) Partial net operating loss carryover.
 - (4) Net capital loss carryovers.
- (c) Step Two: Section 904(b) adjustments.
- (d) Step Three: Allocation of separate limitation losses.
- (e) Step Four: Allocation of U.S. source losses.
- (f) Step Five: Recapture of overall foreign loss accounts.
- (g) Step Six: Recapture of separate limitation loss accounts.
- (h) Step Seven: Recapture of overall domestic loss accounts.
 - (i) [Reserved]
 - (j) Examples.
 - (k) Effective/applicability date.

[T.D. 9371, 72 FR 72599, Dec. 21, 2007, as amended by T.D. 9595, 77 FR 37580, June 22, 2012]

§ 1.904(g)-1 Overall domestic loss and the overall domestic loss account.

(a) *Overview of regulations.* This section provides rules for determining a taxpayer's overall domestic losses, for establishing overall domestic loss accounts, and for making additions to and reducing such accounts for purposes of section 904(g). Section 1.904(g)-2 provides rules for recapturing the balance in any overall domestic loss account under the general recharacterization rule of section 904(g)(1). Section 1.904(g)-3 provides ordering rules for the allocation of net operating losses, net capital losses, U.S. source losses, and separate limitation losses, and the recapture of separate limitation losses,